

COMMONWEALTH OF KENTUCKY  
BEFORE THE UTILITY REGULATORY COMMISSION

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In the Matter of:

APPLICATION OF RUNNING CREEK DISPOSAL )  
SYSTEM, INC., FOR AN ORDER PURSUANT )  
TO CHAPTER 278 OF THE KENTUCKY REVISED )  
STATUTES AUTHORIZING AN ADJUSTMENT IN )  
RATES FOR THE EXISTING SEWAGE TREATMENT ) CASE NO. 7688  
PLANT SERVING RUNNING CREEK ESTATES )  
SUBDIVISION, JEFFERSON COUNTY, KENTUCKY )

O R D E R

Preface

On December 28, 1979, Running Creek Disposal System, Inc., hereinafter referred to as the "Utility", filed with this Commission a duly verified application seeking an adjustment of its sewage service rate. On March 4, 1980, the "Utility" further filed a motion for authorization to issue a promissory note in the amount of \$150,078.25.

The case was set for hearing at the Commission's offices in Frankfort, Kentucky, on February 20, 1980. All parties of interest were notified with the Consumer Protection Division of the Attorney General's Office permitted to intervene in the matter. At the hearing, certain requests for additional information were made by the Commission staff.

Pursuant to the conclusion that all requested information and other pertinent matters have been filed, the entire matter is now considered to be fully submitted for a final determination by this Commission.

Test Period

The Utility has selected the twelve month period ending September 30, 1979, as the "Test-Year" and has submitted tabulations of its revenues and expenses for this period including its

pro forma adjustments thereto for the Commission's consideration in the determination of rate adjustments. Said tabulations along with those found reasonable by this Commission are included in Appendix "C" of this Order.

#### Rate Determination

While the Commission has traditionally considered the original cost of utility plant, the net investment, the capital structure, the cost of reproduction and the going concern in the determination of fair, just and reasonable rates, its experience in the establishment or adjustment of rates for sewage utilities has indicated that these valuation methods are not always appropriate. Sewage utilities are unique to the extent that the cost of facilities has usually been included in the cost of the individual lot. The owner and/or operator of the utility is, in many instances, the developer of the real estate. There are numerous instances of title changing hands prior to the effective date of Commission jurisdiction (January 1, 1975). Further, the Commission has found that the books, records and accounts of many of these utilities are incomplete. In such instances, the fixing of rates on the above methods of valuation is impossible. The Commission is, therefore, of the opinion that the "Operating Ratio Method"<sup>1/</sup> should be utilized in rate-making determinations for sewage utilities although it is recognized that there may be instances where another method could be more valid.

#### Findings in this Matter

The Commission, after consideration of all the evidence of record and being advised, is of the opinion and FINDS:

1. That, in this instance, the determination of rates and revenue requirements should be based on the operating ratio method.

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<sup>1/</sup> Operating ratio is defined as the ratio of expenses, including depreciation and taxes to gross revenues.

$$\text{Operating Ratio} = \frac{\text{Operating Expenses} + \text{Depreciation} + \text{Taxes}}{\text{Gross Revenues}}$$

2. That the Commission should consider 185 customers (T.E., p. 39) in its determination of pro forma adjustments to the Utility's test-year revenues and expenses.

3. That the rate prescribed and set forth in Appendix "A", attached hereto and made a part hereof, is the fair, just and reasonable rate to be charged for sewage services rendered by the Utility, in the Running Creek Estates Subdivision of Jefferson County, Kentucky. Further that said rate should produce annual revenues of \$40,182 from 185 customers.

4. That an operating ratio of .88 results from the projected operations as adjusted and provides a reasonable return margin<sup>2/</sup> in this instance. Further, that interest expense associated with long-term debt should not be and was not included in computing the 0.88 operating ratio.

5. That the rate proposed by the Utility is unfair, unjust and unreasonable in that it would produce revenues in excess of those found reasonable herein and should be denied.

6. That the Utility has filed with this Commission a valid Third-Party Beneficiary Agreement.

7. That the Utility's "Motion for Authorization to Issue Evidence of Indebtedness" filed March 4, 1980, should be approved.

8. That the expense requested for payment of interest on money borrowed to cover operating deficits for 1976, 1977 and 1978 should be denied on the basis that it would be equivalent to retroactive ratemaking.

9. That the Utility's method of depreciation is considered to be excessive and unreasonable and has been computed by the Commission on the basis of the straight line method and estimated useful lives of: 25 years for the site, foundation and control

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<sup>2/</sup> Return margin is the amount remaining for the payment of a return on the investment of the security holders.

building, 15 years for equipment, 25 years for steel tanks and 10 years for the wood fence, totalling \$7,207. However, to insure that present customers will not be charged for facilities that were constructed for future customers, 74% of this amount (\$5,333) is allowed based on 185 pro forma customers versus 250 customers at total plant capacity.

(10) That while traditionally depreciation on contributed property for ratemaking purposes has been allowed, it has not been a matter of great significance in past years. The value of contributed property in currently operating water and sewage utilities, however, is frequently more than the value of investor financed property. Further, it is common practice for a builder or developer to construct water and sewage facilities that add to the value and salability of his subdivision lots and to expense this investment cost in the sale price of these lots or, as an alternative, to donate these facilities to a utility company.

It is also recognized that many residential and commercial developments in metropolitan areas are served by privately-owned sewage systems. Further, that federal guidelines will require the incorporation of these sewage systems into a regional comprehensive sewer district at such time as connecting trunk lines are made available. Further, that to permit the accumulation of a depreciation reserve on contributed property that is to be abandoned would not, in our opinion, be in the public interest.

The Commission is, therefore, of the opinion and finds that depreciation on contributed property for water and sewage utilities is not justified and should not be included in ratemaking determinations for these utilities. In support of this position and by way of substantiation, we make reference to the cases and decisions listed in Appendix "B", attached hereto and made a part hereof.

(11) That the Commission, after consideration of the tabulation of test-year and pro forma revenues and expenses submitted

by the Utility, concludes that these revenues, expenses and adjustments thereto can be summarized as shown in Appendix "C", attached hereto and made a part hereof. On the basis of the said Appendix "C" tabulation, the Commission further concludes that annual revenues in the amount of \$40,182 are necessary and will permit the Utility to meet its reasonable expenses for providing sewage collection and disposal service to 185 customers.

Orders in this Matter

The Commission, on the basis of the matters hereinbefore set forth and the evidentiary record in this case:

HEREBY ORDERS that the rates prescribed and set forth in Appendix "A", attached hereto and made a part hereof be and they are hereby fixed as the fair, just and reasonable rates of the Utility for providing sewage disposal services to customers located in the Running Creek Estates Subdivision, Jefferson County, Kentucky, to become effective for services rendered on and after the date of this Order.

IT IS FURTHER ORDERED that the rate sought by the Utility be and the same is hereby denied.

IT IS FURTHER ORDERED that the proceeds from the borrowing authorized herein shall be used only for the lawful purposes as set out in the application and record in this matter.

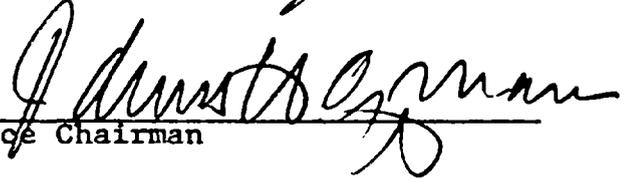
IT IS FURTHER ORDERED that the Utility's request for approval of the issuance of its note for \$150,078.25 at 8% per year be and is hereby approved.

IT IS FURTHER ORDERED that the Utility file with this Commission, within thirty (30) days from the date of this Order, its tariff sheets setting forth the rate approved herein. Further, that a copy of the Utility's Rules and Regulations for providing service to its customers shall be filed with said tariff sheets.

Done at Frankfort, Kentucky, this 1st day of August, 1980.

UTILITY REGULATORY COMMISSION

  
Chairman

  
Vice Chairman

  
Commissioner

ATTEST:

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Secretary

APPENDIX "A"

APPENDIX TO AN ORDER OF THE UTILITY REGULATORY  
COMMISSION IN CASE NO. 7688 DATED AUGUST 1, 1980

The following rates are prescribed for sewage disposal services rendered to all customers served by the Running Creek Disposal System, Inc., Running Creek Estates Subdivision, Jefferson County, Kentucky.

<u>Type of Service Provided</u>	<u>Monthly Rate</u>
Single-Family Residential	\$18.10 per Residence
Multi-Family Residential:	
3-Bedroom Dwelling Unit	18.10 per Dwelling Unit
2-Bedroom Dwelling Unit	13.60 per Dwelling Unit
1-Bedroom Dwelling Unit	9.05 per Dwelling Unit

APPENDIX "B"

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC  
SERVICE COMMISSION IN CASE NO. 7688 DATED  
AUGUST 1, 1980

A listing of cases and decisions that substantiate Finding  
Number 7.

- (1) 28 U.S.C. § 362(c) (1976).

Dealing with the Basis to Corporations in Reorgani-  
zation. It states in part that property contributed  
by nonstockholders to a corporation has a zero basis.

- (2) Easter V. C.I.R., 338 F. 2d 968 (4th Cir. 1964).

Taxpayers are not allowed to recoup, by means of de-  
preciation deductions, an investment in depreciable  
assets made by a stranger.

- (3) Martigney Creek Sewer Co., (Mo. Pub. Serv. Comm.,  
Case No. 17,117) (November 26, 1971).

For rate making purposes a sewer company should not  
be allowed to treat depreciation on contributed plant  
as an operating expense.

- (4) Re Incline Village General Improv. Dist., I & S 558,  
I & 559, (Nev. Pub. Serv. Comm., May 14, 1970).

Where a general improvement district sought to in-  
crease water rates, the Commission could not consider  
depreciation expense on the district's plant because  
all of the plant had been contributed by members of  
the district.

- (5) Princess Anne Utilities Corp. v. Virginia ex rel.  
State Corp. Commission, 179 SE 2d 714, (Va. 1971).

A depreciation allowance on contributions in aid of  
construction was not allowed to a sewer company  
operating in a state following the "original cost"  
rule in determining rate base because the company  
made no investment in the property, and had nothing  
to recover by depreciating the donated property.

APPENDIX "C"

APPENDIX TO AN ORDER OF THE UTILITY REGULATORY  
COMMISSION IN CASE NO. 7688 DATED AUGUST 1, 1980

In accordance with Finding No. 7, the following tabulation is the Commission summary of the "Test-Year" and projected annual revenues and expenses for the Utility's 110,000 GPD sewage collection and treatment system for providing service to test-year and pro forma customers.

	Test Year <sup>(1)</sup> Ending <u>9/30/79</u>	Pro Forma <sup>(1)</sup> <u>Requested</u>	Pro Forma Found <u>Reasonable</u>
(No. of Customers)	(160)	(250)	\$ (185) <sup>(2)</sup>
<u>Revenues:</u>	\$17,681	\$61,653	\$40,182
<u>Expenses:</u>			
1. Utilities			
a) Water	\$ 1,268	\$ 1,423	\$ 1,466 <sup>(3)</sup>
b) Electric	5,395	9,955	6,240 <sup>(3)</sup>
c) Telephone	150	150	150
2. Operation & Maintenance			
a) Routine O & M - Contract	1,385	3,000	3,000
b) Repairs & Maintenance	3,209	3,300	1,484 <sup>(4)</sup>
c) Sludge Hauling	170	1,710	285 <sup>(5)</sup>
d) Chemicals & Supplies	1,089	1,700	985 <sup>(6)</sup>
e) Health Dept. fees	700	700	700
3. Professional Services			
a) Accounting & Bookkeeping	1,525	1,825	1,763 <sup>(3)</sup>
b) Engineering (Rate Case \$2,000/3 years)	-0-	667	667
c) Legal - Annual	553	500	500
d) Legal (Rate Case \$2,000/3 years)	-0-	667	667
4. Taxes			
a) Property	324	444	444
b) Local, State & Federal Corp.	96	2,266	913 <sup>(7)</sup>
5. Administrative & General			
a) Rent	600	600	600
b) Trustee Fee	100	100	100
c) Management Fee	2,400	2,400	1,200 <sup>(8)</sup>
d) Miscellaneous	25	-0-	-0-
6. Billing & Collecting	556	1,284	1,089 <sup>(9)</sup>
7. Insurance	233	233	233
8. Depreciation	9,563	9,563	5,333 <sup>(10)</sup>
9. Interest	<u>-0-</u>	<u>11,768</u>	<u>8,591<sup>(11)</sup></u>
Total Expenses	\$29,341	\$ 54,255	\$36,410
Net Income (loss)	( 11,660)	7,398	3,772

- (1) Test Year and Pro Forma Requested Revenues and Expenses were taken from the Applicant's Comparative Income Statement for the twelve (12) month period ending September 30, 1979.
- (2) In accordance with Finding Number 2 herein, 185 pro forma customers were considered to be more reasonable than 250.
- (3) The Commission's allowances for these pro forma expenses were based on the ratio of 185 pro forma customers to 160 test-year customers and the test-year expense.
- (4) Four years was allowed for recoupment of the \$2,300 for filter sand replacement in accordance with the testimony in this matter (T.E., p. 82). The \$1,484 allowed by the Commission then is  $(\$3209 - 2300) + (\$2300 \div 4)$ .
- (5) The pro forma allowance of \$285 for sludge hauling is based on 3 loads x \$95.
- (6) The amount found reasonable for chemicals and supplies was determined from the invoices supplied by the utility that were dated within the test-year. Two of the invoices were outside the test year.
- (7) State and Federal Tax Liability has been computed on the basis of the revenues made possible from the rates approved herein.
- (8) The Applicant's request for \$2,400 for Management Fees has been reduced to \$1,200 based on previous allowances for comparable utilities operating in Jefferson County, Kentucky, and the testimony in this matter. (T.E., p. 77, 78).
- (9) An expense of \$1,089 was allowed for billing and collecting based on apportionment of the \$1.36 charge of the collection agency (Louisville Water Comany) for each bi-monthly bill which includes the customer's charge for both water and sewage service.

- (10) An annual expense of \$5,333 was allowed based on Finding Number 9 set forth herein.
- (11) Seventy-four percent of the pro forma requested interest found reasonable per Finding Number 8 herein was allowed. Present customers should not be charged for interest on those facilities that were constructed for future customers.